

~~CR~~
CR2

REBUTTAL TESTIMONY
OF
JANIS FREETLY
SENIOR FINANCIAL ANALYST
FINANCE DEPARTMENT
FINANCIAL ANALYSIS DIVISION
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY

**Petition for Approval of Delivery Services Tariffs and Tariff Revisions
and Residential Delivery Services Implementation Plan, and for
Approval of Certain Other Amendments and Additions
to its Rates, Terms, and Conditions**

Docket No. 01-0423

October 16, 2001

OFFICIAL FILE

I.C.C. DOCKET NO. 01-0423
Staff EXHIBIT 19.0 CR2

Witness

Date 11/14/01

Witness Signature

Table of Contents

Witness Identification.....	1
Response to Mr. Ebright.....	2
Response to Mr. Thone	10
Response to Dr. Peltzman	20

1 **Witness Identification**

2 **Q. Please state your name and business address.**

3 A. My name is Janis Freetly. My business address is 527 East Capitol Avenue,
4 Springfield, Illinois 62701.

5 **Q. Are you the same Janis Freetly who previously testified in this proceeding?**

6 A. Yes, I am.

7 **Q. Please state the purpose of your rebuttal testimony.**

8 A. The purpose of my rebuttal testimony is to respond to the rebuttal testimony of
9 several ComEd witnesses, including John Ebright, Daniel Thone, and Sam
10 Peltzman. I will address several issues involving the capital structure and the
11 appropriate overall cost of capital for Commonwealth Edison ("ComEd") in this
12 proceeding.

13 **Q. Please summarize your overall cost of capital recommendation.**

14 A. My overall cost of capital recommendation is 8.77%, and is shown in Schedule
15 19.1.

16

Response to Mr. Ebright

17 **Q. Should ComEd's capital structure reflect the scheduled retirements of**
18 **Transitional Funding Instruments ("TFIs")?**

19 **A. No. The Commission should reject ComEd's proposed pro forma adjustments to**
20 reflect the scheduled retirements of TFIs. Although the retirement dates are known,
21 the manner in which such retirements are to be refinanced is not. Mr. Ebright
22 suggests that the Commission disassociate debt maturity from debt refinancing
23 from its determination of known and measurable changes to capital structure. If the
24 Commission accepts his proposal, a downward bias of Illinois utility common equity
25 ratios for ratemaking purposes would result. Since debt is issued with specific
26 maturity dates, one will always know when a debt issue is scheduled to be retired
27 before one knows how it will be replaced.

28 Further, on October 10, 2001, ComEd filed an Informational Statement pursuant to
29 6-102(d) of the Public Utilities Act for authority to refinance up to \$2 billion of stock,
30 bonds, notes, or other evidences of indebtedness over the period of October 26,
31 2001 through October 26, 2004. The filing did not specify which securities would be
32 re-financed. This was not a known and measurable change to Staff just one-month
33 prior when ComEd filed its rebuttal case. This filing indicates that the embedded
34 cost of debt and the outstanding balance of long-term debt could dramatically
35 change from those sponsored by all parties in this proceeding in a relatively short

36 time period. I identified approximately \$2 billion of debt issues, including TFIs, that
37 will mature during the 2001 through 2004 period. I do not propose any adjustments
38 to the balance or embedded cost of long-term debt in response to this filing, but it
39 suggests the danger of disassociating debt retirements from refinancing.

40 **Q. Did ComEd's supplemental response to JF-1.20 satisfy your concern**
41 **regarding ComEd's inconsistent pro forma adjustments with respect to**
42 **time?**

43 **A.** No. ComEd's supplemental response to JF-1.20 was insufficient to alleviate my
44 concern. The forecasted financial statements provided for 2001 were incomplete.
45 Furthermore, ComEd did not provide the underlying assumptions supporting the
46 financial forecast. Thus, I could not test their validity. ComEd also stated that the
47 forecasted financial statements for 2002 were still unavailable. Without the
48 forecasted financial statements, ComEd's claim that it will generate enough funds
49 internally to cover the retirements of these TFIs cannot be verified.

50 **Q. Should the \$1.062 billion account receivable from Exelon be included in**
51 **ComEd's balance of common equity?**

52 **A.** No. ComEd claims that the \$1.062 billion receivable from Exelon will be used to
53 pay off future tax liabilities on the intangible transition charges that ComEd will
54 collect from 2001 through 2008. ComEd will record the associated tax liability as

55 revenues from the intangible transition charges are recorded. Since Exelon files
56 consolidated income tax returns, ComEd would pay its portion of Exelon's
57 consolidated income tax liability to Exelon, which in turn would pay the taxing
58 authority.¹ ComEd will "collect" on the receivable each year as the income taxes
59 come due.² Hence, as revenues are collected, the income tax liability is recorded
60 and as the associated taxes become due, ComEd collects on the receivable from
61 Exelon, which in turn pays Exelon for the taxes, which pays the taxes to the taxing
62 authorities. Thus, ComEd will not have one additional dollar of common equity
63 capital that it can invest. ComEd has managed to show an additional \$1 billion in
64 common equity only because it did not match the receivable with the liability it is
65 designed to offset. Essentially, ComEd created \$1 billion of equity that does not
66 exist. ComEd should not be able to increase rates for what amounts to a
67 bookkeeping gimmick.

68 **Q. Is your position consistent with the Securities and Exchange Commission's**
69 **(SEC) treatment of the receivable?**

70 **A.** Yes. ComEd did not include the \$1 billion receivable from Exelon in the balance of
71 common equity when reporting to the SEC.³ The receivable evidences a promise
72 by Exelon to contribute capital. The SEC rules dictate that until capital is actually

¹ ComEd Response to Staff Data Request JF-7.02.

² ComEd Response to Staff Data Request JF-7.01.

³ ComEd Form 10Q, Quarterly Report to the SEC for the Quarter Ended March 31, 2001.

73 transferred, the balance of common equity should not reflect the additional funds.⁴
74 Exelon's promise of future equity extends through 2008. Therefore, it would be
75 imprudent to include the entire amount in the balance of common equity as of March
76 31, 2001. Moreover, there is no guarantee that ComEd will ever realize additional
77 common equity from this receivable since ComEd could declare higher dividends to
78 Exelon from the reduction in taxes it pays to Exelon net of the collections on the
79 receivable.

80 **Q. If the \$1 billion is included in ComEd's capital structure for the purposes of**
81 **this proceeding, what would be the impact on your cost of equity**
82 **recommendation?**

83 **A.** Adding the additional \$1.062 billion common equity to my recommended capital
84 structure would increase the common equity ratio to 44%. If the Commission
85 accepts ComEd's position and includes the \$1.062 billion in the balance of
86 common equity, I recommend that the cost of common equity be lowered based
87 upon the new common equity ratio. The results of the analyses that I performed
88 indicate that the appropriate cost of capital for the delivery service operations of
89 ComEd is 8.77%. In order to keep that number constant, adjusting the common
90 equity ratio to 44%, implies a cost of equity of 11.20%. Since the embedded cost
91 of debt does not change with capital structure, only the cost of equity estimate

⁴ SEC Staff Accounting Bulletin 4(g).

needs to be adjusted if the Commission agrees with ComEd that the \$1 billion should be included in the capital structure. Nevertheless, I strongly urge the Commission to exclude the \$1 billion from the common equity balance that will be used for setting rates.

Q. Mr. Ebright claims that the Uniform System of Accounts (USOA) required ComEd to report obligations from associated companies in Account 145 (Notes Receivable from Associated Companies) or Account 146 (Accounts Receivable from Associated Companies) as a separate balance sheet item under current and accrued assets. Do you agree?

A. No. According to the USOA, Accounts 145 and 146 shall only include receivables from associated companies that are expected to be paid in full not later than one year from the date of issue. This receivable is expected to be paid over the years 2001 through 2008. Therefore, ComEd recorded this receivable from Exelon incorrectly. Further, the USOA does not dictate ratemaking treatment.⁵ Since the receivable does not lead to an increase in the amount of equity capital available to ComEd, ComEd's corresponding adjustment to common equity should not be included in the balance of common equity that will be used to determine the overall cost of capital for the purposes of this proceeding.

⁵ Uniform System of Accounts for Electric Utilities Operating in Illinois, Effective February 1, 1999, General Instruction 1C.

110 **Q. Do you agree that the carrying value of long-term debt should be adjusted**
111 **to reflect the current market rates at the time of the merger of Unicom and**
112 **PECO?**

113 **A.** No. When determining the overall rate of return for ratemaking purposes, the
114 embedded cost of debt should be used. The proposed adjustment to the carrying
115 value of long-term debt has the effect of adjusting the cost of debt to current market
116 rates at the time of the merger of Unicom and PECO. Adjusting to fair value would
117 result in an inaccurate representation of the balance and cost of long-term debt that
118 ComEd actually incurred. Restating Accounts 225 (Unamortized Premium on Long-
119 Term Debt) and 226 (Unamortized Discount on Long-Term Debt) to fair value and
120 attempting to pass those changes through to ratepayers results in passing costs
121 associated with the merger to ratepayers.

122 Moreover, to facilitate the tracking of those costs for the purpose of setting rates, the
123 Commission should order ComEd to maintain records on the annual amortization
124 and unamortized balances of debt discount and premium associated with the fair
125 value and original cost in separate subaccounts. ComEd should also be required to
126 report the amounts recorded in those separate subaccounts in its Annual Report to
127 the Commission. Specifically the "Unamortized Debt Expense, Premium, and
128 Discount on Long-Term Debt" schedule of the Form 21 Annual Report to the
129 Commission should reflect the original discount, premium, and expense. The

instructions state that column c should show the expense, premium, or discount with respect to the amount of bonds or other long-term debt originally issued. The information reflected in columns c through i should be for the original discount, premium, and expense rather than the amount based on fair value. If ComEd cannot continue to record and track the original discount and premium amounts, the Company should not be allowed to recover any discount or premium on the associated debt issues. ComEd should not be able to recover expenses from ratepayers that it cannot substantiate.

ComEd claims that the revaluation of long-term debt to fair value to reflect the purchase method of accounting adjustments results in the "new original cost" of debt. The absurdity of this oxymoronic phrase requires little comment. Nevertheless, to ensure there is no confusion, I submit that a debt security cannot have more than one original cost in its lifetime. The Commission should reject this ridiculous notion, and my recommended balance and embedded cost of long-term debt, presented in Schedule 19.2, should be adopted.

Q. Is the Commission Staff investigating ComEd's booking of the receivable and the restatement of the unamortized discount and premium on long-term debt?

A. Yes. Mary Selvaggio, Manager of the Commission's Accounting Department sent a letter to ComEd on September 26, 2001, to inform Mr. Ebright that ComEd is not

150 in compliance with the USOA with regard to the \$1 billion intercompany receivable
151 and the restatement of the unamortized discount and premium on long-term debt.
152 Mr. Ebright replied to Ms. Selvaggio's letter on October 9, 2001. The Accounting
153 Staff is further investigating ComEd's booking of the receivable and the restatement
154 of the discount and premium to fair value.

155 **Q. Do you agree with Mr. Ebright's claim that the face amount outstanding for**
156 **the First Mortgage Bonds Series 75 should be \$250 million instead of \$260**
157 **million as shown on page 1 of Schedule 5.2 attached to your direct**
158 **testimony?**

159 **A.** Yes. I made an error in my debt schedule. I have revised Schedule 5.2 to reflect the
160 \$250 million face amount outstanding and the corresponding annualized interest
161 expense. The revised schedule is attached to this testimony as Schedule 19.2.

162 **Q. Do you accept the interest rates presented by Mr. Ebright on page 8 of his**
163 **rebuttal testimony as the appropriate rates to use for the variable rate long-**
164 **term debt?**

165 **A.** Yes. I accept the interest rates as ComEd's actual rates as of August 31, 2001 for
166 the variable rate issues. Hence, I adjusted the annualized interest expense of the
167 1994B and 1994C Pollution Control Obligations and the variable rate Medium-Term
168 Notes to reflect the updated interest rates.

169 **Q. Did you make any other changes to your long-term debt schedule that was**
170 **presented as Schedule 5.2, attached to your direct testimony?**

171 **A.** Yes. I found an error in the face amount outstanding of the 5.29% Class A-2
172 Intangible Transition Property Notes. The correct balance is \$81, 515,431.

173 **Q. What effect do these changes to your long-term debt schedule have on your**
174 **recommended balance and embedded cost of long-term debt?**

175 **A.** The balance of long-term debt is decreased by \$72,233,211. The new balance is
176 \$7,556,954,485. My embedded cost of long-term debt increased to 6.83%.

177 **Response to Mr. Thone**

178 **Q. Do you have any comments regarding Mr. Thone's electric and gas**
179 **samples?**

180 **A.** Mr. Thone included companies with at least 50% of total revenues from regulated
181 operations. He claims that he focused on companies whose primary business is
182 distribution. However, percentage of revenue from regulated operations does not
183 necessarily limit the sample to utilities primarily engaged in distribution. Not all
184 states have deregulated generation, therefore, companies with generation assets
185 may be included when that criteria is used. I am not suggesting that including
186 companies with generation, regulated or otherwise, is necessarily wrong. Rather, I

187 am asserting that Mr. Thone's claim that he focused on companies primarily
188 engaged in distribution is questionable.

189 The criteria that I relied on to select the electric and gas utilities that comprise my
190 samples were more stringent than those employed by Mr. Thone. When selecting
191 my samples, I included those companies with 75% or more revenue derived from
192 electric operations for the electric sample, or 75% or more revenue derived from
193 gas operations for the gas sample, based on 2000 data from *Standard & Poor's*
194 (*"S&P" Utility Compustat*). When applying those criteria to Mr. Thone's samples,
195 Cinergy, Consolidated Edison, and Energy East fail to make the cut in the electric
196 sample, and New Jersey Resources and Keyspan Corp. do not pass in the gas
197 sample. Cinergy derives only 63.9% of revenue from electric operations, while
198 Consolidated Edison derives 74.1%, and Energy East only 68.4%.⁶ New Jersey
199 Resources derives only 63.3% of revenue from gas operations.⁷ Keyspan Corp.,
200 which is not even classified under industry number 4924 in *S&P Utility Compustat*,
201 derives only 50% of its operating revenue from gas distribution.⁸ Yet, Mr. Thone
202 criticizes my inclusion of Puget Energy and CLECO in my electric sample because
203 they have gas components. Puget Energy's operating revenue is 81% electric and

⁶ S&P *Utility Compustat*, data from December 31, 2000.

⁷ Ibid.

⁸ Keyspan Corp., 10K Annual Report to the SEC for the Year Ended December 31, 2000,
www.freedgar.com, October 15, 2001.

204 18% gas.⁹ The operating revenue of CLECO is comprised of 75% electric revenue
205 and 25% other.¹⁰ Both companies realize a higher percentage of revenue from
206 electric operations than Cinergy, Consolidated Edison, and Energy East.

207 I also removed companies that have pending significant mergers to ensure that
208 merger premiums did not distort the results of my analysis. Mr. Thone included
209 PEPco in his electric sample even though it is in the process of purchasing
210 Connectiv. He also included Energy East Corp. despite its pending acquisition of
211 RGS Energy Group Inc.

212 **Q. Do the ratios presented by Mr. Thone in his rebuttal testimony accurately**
213 **reflect the leverage of the companies in his samples and the samples that**
214 **you presented in your direct testimony?**

215 **A.** No. The market-based ratios that Mr. Thone presented in Exhibits 27.3 and 27.4
216 attached to his rebuttal testimony do not reflect the short-term debt of the companies
217 in the samples. I recalculated those ratios using the same data source that Mr.

⁹ Puget Energy, Inc., 10K Annual Report to the SEC for the Year Ended December 31, 2000, www.freeedgar.com, October 15, 2001.

¹⁰ CLECO Corp, 10K Annual Report to the SEC for the Year Ended December 31, 2000, www.freeedgar.com, October 15, 2001 .

218 Thone employed¹¹ to include short-term debt. The results are presented on
219 Schedules 19.3 and 19.4.

220 **Q. Why should short-term debt be included in the capital structure ratios?**

221 A. Short-term debt should be included in the capital structure ratios because financial
222 theory does not distinguish between short and long term debt as a source of
223 financial risk. Proposition I of the Modigliani and Miller model, upon which ComEd's
224 Miller model is based, implies that the choice between long-term debt and short-
225 term debt has no effect on firm value.¹² No distinction between types of debt is
226 necessary; hence, both types of debt should be included when calculating capital
227 structure ratios.¹³ Standard & Poor's also includes short-term debt when calculating
228 capital structure ratios.¹⁴ Further, gas utilities make extensive use of short-term
229 debt to purchase gas for distribution to customers. As a constant source of capital,
230 exclusion of short-term debt when computing capital structure ratios would result in
231 an inaccurate representation of the leverage used by gas utilities.

232 **Q. Are Mr. Thone's conclusions regarding the comparability of your samples to**
233 **ComEd accurate?**

¹¹ Moneycentral.msn.com, September 28, 2001.

¹² Brealey and Myers, Principles of Corporate Finance, Sixth Edition, p. 491.

¹³ If ComEd had any short-term debt, I would have included it in my recommended capital structure for this proceeding.

¹⁴ Standard & Poor's Global Utilities Rating Service, *Financial Statistics - Twelve Months Ended September 30, 1999*, p. 7.

234 A. No. When short-term debt is included in the market-based ratios calculated by Mr.
235 Thone, the results of my analysis put forth in direct testimony are supported. The
236 debt to equity ratios for my samples indicate that my electric sample is more
237 financially levered than ComEd and my gas sample is less financially levered than
238 ComEd. In terms of financial leverage, ComEd is closer to my gas sample than my
239 electric sample. This data supports my final cost of equity recommendation for
240 ComEd, which weighted the gas sample by two-thirds and the electric sample by
241 only one-third. The data also supports my position that a leverage adjustment is not
242 necessary.

243 Q. **How did you arrive at that conclusion?**

244 A. The market value of ComEd's common equity cannot be observed because its
245 common stock is not market traded. Therefore, I estimated the market value of
246 ComEd's common equity using the average market to book ratios for the
247 companies in my samples using the same data source that Mr. Thone relied on in
248 his rebuttal testimony. The average market to book ratio for my electric sample is
249 2.17, while that of my gas sample is 1.59. I then compared the debt to market
250 equity ratios of my samples to the implied debt to market equity ratios for ComEd.
251 For the electric sample, the debt to market equity ratio equals 1.01. Applying my
252 electric sample's market to book ratio to ComEd implies a debt to market equity
253 ratio of 0.71 for ComEd. For my gas sample, the average debt to market equity

ratio equals 0.91. Applying my gas sample's market to book ratio to ComEd results in a corresponding implied debt to market equity ratio of 0.97 for ComEd.

Q. Using the same data source that Mr. Thone employed for the calculations presented in his rebuttal testimony, how does the book value capital structure that you are proposing for ComEd compare to the book value capital structures of the companies in Mr. Thone's samples?

A. Including short-term debt in the calculations results in an average total debt to equity ratio in terms of book value of 1.81 for Mr. Thone's electric sample and 1.25 for his gas sample. ComEd's book value total debt to equity ratio is 1.53, based on my recommended capital structure consisting of 39.59% equity and 60.41% debt. The average common equity to total capitalization ratio equals 35.98% for his electric sample and 44.98% for his gas sample. The average total debt to total capitalization equals 62.62% for Mr. Thone's electric sample and 54.40% for his gas sample. The data supports Staff's position that Mr. Thone's samples are not significantly different from ComEd in terms of leverage.

Q. Why do the average book value common equity to total capitalization ratios that you calculated differ from those shown by Mr. Thone?

A. Mr. Thone calculated the book equity to total capitalization ratios in a backward manner. He started with the debt to market equity ratio and adjusted it by the

273 market to book ratio to arrive at his estimate of the book equity to total
274 capitalization. Since book equity balances are known and the total capitalization is
275 easily computed by adding the balances of the various capital components, this
276 ratio should be calculated directly for the sample companies using known and
277 measurable data. That is the procedure that I followed to calculate the book value
278 common equity to total capitalization ratios.

279 **Q. Do you agree with Mr. Thone's position that weighted averages are more**
280 **representative of a portfolio?**

281 **A.** Not necessarily. The appropriate weighting of estimates for a sample depends on
282 the objective. If the objective is to measure the rate of return for an industry or the
283 market, then market-weighted estimates should be used since larger companies
284 have a greater affect on the market or industry as a whole than smaller companies.
285 However, the objective in using a sample to measure the cost of common equity for
286 a single company, as is the purpose at hand, is the reduction in measurement error.
287 There is no necessary relationship between the size of a company and the reduction
288 of measurement error. The companies comprising a sample should be weighted
289 differently only if there is reason to believe that some of the companies are closer in
290 risk to the subject company than others.¹⁵

291 **Q. Has the Commission rejected market value weighting?**

292 A. Yes. This argument was entertained in Docket No. 99-0122/99-0130 Consol.
293 MidAmerican Energy Company argued that Staff's DCF results should have been
294 weighted by market value. The Commission rejected the Company's arguments
295 and accepted Staff's rate of return recommendation.¹⁶

296 **Q. Please comment on Mr. Thone's concerns that applying market returns to**
297 **book values will under-fund the necessary returns when book values are**
298 **less than market values.**

299 A. To establish utility rates, regulators generally apply a market-based rate of return to
300 a book value rate base. If that process provided a return that did not meet investor
301 requirements, market prices would fall toward book value. Yet, the market prices of
302 utility stocks, such as all of the utilities that comprise the samples used by Mr. Thone
303 and myself, continue to exceed book value. Thus, since a market to book
304 adjustment was not necessary for achieving current market to book values, it cannot
305 be necessary to support those values. In fact, a market to book adjustment would
306 only increase the present disparity between market and book. Therefore, ComEd is
307 not entitled to a return on common equity in excess of the investor-required rate of
308 return. Utility customers should not pay higher rates simply because utility stock
309 prices are in excess of book values. The Commission has previously rejected the
310 false notion that utilities should be authorized rates of return in excess of the

¹⁵ Under this approach, companies would be weighted on the basis of closeness in risk, not size.

311 investor-required rate of return whenever their market values exceed book values.¹⁷
312 To substantiate his assertion that ComEd should be allowed to earn a greater rate
313 of return on book value rate base to provide the rate of return investors require on
314 the market value of common equity, Mr. Thone would have to establish why the
315 market prices of utility stocks exceed book value and why market prices of utility
316 stocks continue to exceed book value if market-based rate of return rewards are
317 insufficient to meet investor requirements.

318 **Q. Do you agree with Mr. Thone's statement that you portray *Value Line* data**
319 **as irrelevant and suggest that investors would not pay attention to it?**

320 **A.** No. I did not portray Value Line data as irrelevant. My testimony rejected use of the
321 comparable earnings methodology, as the Commission has consistently done in
322 past cases.¹⁸ The comparable earnings method measures accounting returns;
323 nothing exists in that measure that indicates whether that return equals investor
324 requirements since its denominator, book value, does not readily respond to
325 dynamic market forces. Thus, if investors accept Value Line's estimates of return on
326 book equity, but find those estimates exceed their required rate of return, then they
327 will bid up the stock prices rather than book value of those companies. Conversely,
328 if investors find Value Line's estimates of return on book equity are less than their

¹⁶ Order, Docket No. 99-0122/99-0130 Consol., August 25, 1999, p. 10.

¹⁷ Docket No. 99-0121, p. 68; Amended Order, Docket No. 97-0351, p. 42; Order, Docket No. 95-0076, p. 69.

329 required rates of return, then they will bid down the stock prices rather than book
330 value of those companies. Further, accounting returns may not be directly
331 comparable between companies that follow different accounting practices. In its
332 Order in Docket No. 99-0121, the Commission concluded that the comparable
333 earnings method does not produce a reliable return for ratemaking purposes.

334 **Q. What is your response to Mr. Thone's position that it is inappropriate to give**
335 **more weight to the gas sample?**

336 **A.** Although I recognize that gas utilities may be exposed to commodity risks that
337 electric distribution companies do not face, the data that I relied on to examine the
338 relative riskiness of my samples to ComEd indicated that the sample of gas utilities
339 that I used was closer to ComEd in terms of risk. Individual companies within
340 industries do not necessarily share the average risk profile of the overall industry.
341 Since the purpose at hand is to determine the appropriate return on equity for the
342 delivery service operations of ComEd, the sample that better represents the
343 quantity of risk that ComEd faces should be given more weight. Although my gas
344 sample was less risky than ComEd, it was closer in risk to ComEd than my electric
345 sample, which was higher in risk. Therefore, the relative risk positions of the
346 specific companies of the electric and gas industries that I utilized to perform my

¹⁸ Order, Docket No. 99-0121, August 25, 1999, p. 68; Order on Remand, Docket No. 89-0033, November 3, 1999, p. 5; Order, Docket No. 92-0448/93-0239 Consol., October 11, 1994, p. 173.

347 cost of equity analysis clearly indicate that the gas sample should be given more
348 weight than the electric sample.

349 **Response to Dr. Peltzman**

350 **Q. What is your response to ComEd witness Sam Peltzman's assertion that**
351 **changes in debt ratings do not reflect the risk that will affect the cost of**
352 **equity capital?**

353 **A.** An S&P Issuer Credit Rating is a current opinion of an obligor's overall financial
354 capacity (its creditworthiness) to pay its financial obligations. This opinion focuses
355 on the obligor's capacity and willingness to meet its financial commitments as they
356 come due.¹⁹ The methodology followed by S&P when assigning utilities ratings
357 encompasses two basic components: business risk analysis and financial analyses.
358 When assessing a firm's financial condition, S&P evaluates industry characteristics,
359 the utility's position within that industry, its regulation, and its management.²⁰

360 Mr. Thone used S&P credit ratings as a selection criterion for his sample
361 companies, which suggests that companies with ratings similar to ComEd are
362 similar in risk and equity investors would have similar return expectations.

¹⁹ Standard & Poor's, *Utilities Rating Service: Financial Statistics, Twelve Months Ended June 30, 1998*, p. 1.

²⁰ S&P, *Utilities Rating Service: Industry Commentary*, May 20, 1996, p. 1.

363 According to ComEd's S&P credit rating and business profile position, an upward
364 adjustment to the cost of equity is unwarranted.

365 **Q. Does this conclude your direct testimony?**

366 **A. Yes, it does.**

Company Proposal

Pro-forma December 31, 2000

<u>Component</u>	<u>Balance</u>	<u>Percent of Total Capital</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-term Debt	\$6,963,798,000 ¹	53.99%	7.14%	3.86%
Common Equity	<u>\$5,933,786,000 ²</u>	<u>46.01%</u>	13.25%	<u>6.10%</u>
Total Capital	\$12,897,584,000	100.00%		
Weighted Average Cost of Capital				9.95%

¹ Pro-forma adjustments through December 31, 2002

² Pro-forma adjustments through January 2001

Staff Proposal

March 31, 2001

<u>Component</u>	<u>Balance</u>	<u>Percent of Total Capital</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-term Debt	\$7,556,954,485	60.41%	6.83%	4.13%
Common Equity	<u>\$4,952,000,000</u>	<u>39.59%</u>	11.72%	<u>4.64%</u>
Total Capital	\$12,508,954,485	100.00%		
Weighted Average Cost of Capital				8.77%

Description	Coupon Rate	Date Issued	Maturity Date	Face Amount Outstanding	Unamortized Discount or Premium	Unamortized Debt Expense	Carrying Value	Annualized Coupon Interest	Annualized Amortization of Discount or Premium	Annualized Amortization of Debt Expense	Annualized Debt Expense
First Mortgage Bonds											
Series 85	7.375%	09/15/92	09/15/02	\$200,000,000	(\$181,594)	\$12,231	\$200,169,363	\$14,750,000	(\$124,356)	\$8,376	\$14,634,020
Series 96	6.625%	07/15/93	07/15/03	\$100,000,000	\$280,643	\$18,350	\$99,701,007	\$6,625,000	\$122,530	\$8,012	\$6,755,541
Pollution Control-1994A	5.300%	01/15/94	01/15/04	\$26,000,000	\$40,241	\$29,162	\$25,930,597	\$1,378,000	\$14,400	\$10,435	\$1,402,835
Series 93	7.000%	07/01/93	07/01/05	\$225,000,000	\$911,538	\$52,963	\$224,035,499	\$15,750,000	\$214,238	\$12,448	\$15,976,686
Series 76	8.250%	10/01/91	10/01/06	\$100,000,000	(\$1,526,846)	\$43,959	\$101,482,887	\$8,250,000	(\$277,263)	\$7,983	\$7,980,719
Series 78	8.375%	10/15/91	10/15/06	\$125,000,000	(\$2,198,910)	\$51,569	\$127,147,342	\$10,468,750	(\$396,543)	\$9,300	\$10,081,507
Pollution Control-1996A	4.400%	06/27/96	12/01/06	\$110,000,000	\$1,465	\$1,335,748	\$108,662,787	\$4,840,000	\$258	\$235,417	\$5,075,675
Pollution Control-1996B	4.400%	06/27/96	12/01/06	\$89,400,000	\$1,190	\$1,090,483	\$88,308,326	\$3,933,600	\$210	\$192,190	\$4,126,000
Series 83	8.000%	05/15/92	05/15/08	\$140,000,000	(\$1,741,318)	\$77,890	\$141,663,428	\$11,200,000	(\$244,266)	\$10,926	\$10,966,660
Pollution Control-1994B	5.700%	01/15/94	01/15/09	\$20,000,000	\$374,206	\$39,616	\$19,586,178	\$1,140,000	\$47,975	\$5,079	\$1,193,054
Pollution Control-1991	7.250%	06/01/91	06/01/11	\$100,000,000	(\$840,152)	\$171,728	\$100,668,423	\$7,250,000	(\$82,567)	\$16,877	\$7,164,309
Series 92	7.625%	04/15/93	04/15/13	\$220,000,000	\$2,027,568	\$156,191	\$217,816,240	\$16,775,000	\$168,272	\$12,963	\$16,956,235
Series 94	7.500%	07/01/93	07/01/13	\$150,000,000	\$2,401,298	\$67,621	\$147,531,082	\$11,250,000	\$195,860	\$5,515	\$11,451,375
Pollution Control-1994C	5.850%	01/15/94	01/15/14	\$20,000,000	\$1,083,597	\$48,771	\$18,867,633	\$1,170,000	\$84,638	\$3,809	\$1,258,447
Pollution Control-1994D	6.750%	12/01/94	03/01/15	\$91,000,000	\$1,475,597	\$1,708,912	\$87,815,491	\$6,142,500	\$105,960	\$122,714	\$6,371,173
Series 75	9.875%	06/15/90	06/15/20	\$250,000,000	(\$14,865,328)	\$349,234	\$264,516,094	\$24,687,500	(\$773,353)	\$18,169	\$23,932,315
Series 81	8.625%	02/01/92	02/01/22	\$200,000,000	(\$323,411)	\$302,402	\$200,021,010	\$17,250,000	(\$15,508)	\$14,500	\$17,248,993
Series 84	8.500%	07/15/92	07/15/22	\$200,000,000	\$759,736	\$360,012	\$198,880,252	\$17,000,000	\$35,661	\$16,899	\$17,052,560
Series 86	8.375%	09/15/92	09/15/22	\$200,000,000	\$2,149,137	\$190,094	\$197,660,769	\$16,750,000	\$100,081	\$8,852	\$16,858,933
Series 88	8.375%	02/15/93	02/15/23	\$235,950,000	\$2,430,098	\$196,309	\$233,323,593	\$19,760,813	\$110,998	\$8,967	\$19,880,777
Series 91	8.000%	04/15/93	04/15/23	\$160,000,000	\$4,871,608	\$117,434	\$155,010,957	\$12,800,000	\$220,887	\$5,325	\$13,026,211
Series 97	7.750%	07/15/93	07/15/23	\$150,000,000	\$7,019,887	\$79,888	\$142,900,226	\$11,625,000	\$314,735	\$3,582	\$11,943,317
Total First Mortgage Bonds				\$3,112,350,000	\$4,150,247	\$6,500,567	\$3,101,699,185	\$240,796,163	(\$177,154)	\$738,336	\$241,357,345
Sinking Fund Debentures											
2.875%	2.875%	10/01/50	04/01/01	\$1,000,000	\$1	\$12	\$999,987	\$28,750	\$422	\$4,369	\$33,541
3.125%	3.125%	10/01/54	10/01/04	\$4,925,000	\$50,118	\$12,677	\$4,862,205	\$153,906	\$14,291	\$3,615	\$171,813
3.875%	3.875%	01/01/58	01/01/08	\$8,000,000	\$224,366	\$22,394	\$7,753,240	\$310,000	\$33,196	\$3,313	\$346,509
4.625%	4.625%	01/01/59	01/01/09	\$3,568,000	\$103,736	\$13,094	\$3,451,169	\$165,020	\$13,365	\$1,687	\$180,072
4.750%	4.750%	12/01/61	12/01/11	\$9,181,000	(\$460,232)	\$30,535	\$9,610,697	\$436,098	\$0	\$2,860	\$438,957
Publishing Fee's Annual Notice										\$28,942	\$28,942
Publishing Fee's Annual Notice										\$14,470	\$14,470
Total Sinking Fund Debentures				\$26,674,000	(\$82,011)	\$78,713	\$26,677,297	\$1,093,774	\$61,274	\$59,256	\$1,214,304
Sub. Deferrable Interest Notes											
Sub. Deferrable Interest Notes	8.480%	09/26/95	09/30/35	\$206,190,000		\$5,920,163	\$200,269,837	\$17,484,912		\$171,483	\$17,656,395
Sub. Def. Interest Debentures	8.500%	01/24/97	01/15/27	\$154,640,000		\$1,678,019	\$152,961,981	\$13,144,400		\$65,012	\$13,209,412
Total Sub. Def. Interest Notes				\$360,830,000		\$7,598,182	\$353,231,818	\$30,629,312		\$236,495	\$30,865,807

Docket No. 01-0423
ICC Staff Exhibit 19.0
Schedule 19.2
2

Description	Coupon Rate	Date Issued	Maturity Date	Face Amount Outstanding	Unamortized Discount or Premium	Unamortized Debt Expense	Carrying Value	Annualized Coupon Interest	Annualized Amortization of Discount or Premium	Annualized Amortization of Debt Expense	Annualized Debt Expense
Transitional Funding Notes											
Class A-2 Int. Trans. Prop. Notes	5.290%	12/16/98	06/25/01	\$81,515,431		\$68,206	\$81,447,225	\$4,312,166		\$289,478	\$4,601,645
Class A-3 Int. Trans. Prop. Notes	5.340%	12/16/98	03/25/02	\$258,860,915		\$133,790	\$258,727,125	\$13,823,173		\$136,026	\$13,959,199
Class A-4 Int. Trans. Prop. Notes	5.390%	12/16/98	06/25/03	\$421,139,085		\$357,880	\$420,781,205	\$22,699,397		\$160,081	\$22,859,478
Class A-5 Int. Trans. Prop. Notes	5.440%	12/16/98	03/25/05	\$598,510,714		\$653,945	\$597,856,769	\$32,558,983		\$164,048	\$32,723,031
Class A-6 Int. Trans. Prop. Notes	5.630%	12/16/98	06/25/07	\$761,489,286		\$958,251	\$760,531,035	\$42,871,847		\$153,606	\$43,025,453
Class A-7 Int. Trans. Prop. Notes	5.740%	12/16/98	12/25/08	\$510,000,000		\$677,105	\$509,322,895	\$29,274,000		\$87,453	\$29,361,453
Total Transitional Funding Notes				<u>\$2,631,515,431</u>		<u>\$2,849,178</u>	<u>\$2,628,666,253</u>	<u>\$145,539,565</u>		<u>\$990,694</u>	<u>\$146,530,259</u>
Pollution Control Obligations											
IL Ind. Poll. Control Fin. Auth.	5.875%	05/15/77	05/15/07	\$45,500,000	\$189,476	\$65,849	\$45,244,676	\$2,673,125	\$30,930	\$10,749	\$2,714,804
IL Dev. Fin. Auth. Series 1994B	variable	12/14/94	03/01/09	\$42,200,000	\$500	\$174,708	\$42,024,792	\$957,307	\$27	\$22,050	\$979,384
IL Dev. Fin. Auth. Series 1994C	variable	10/05/94	10/15/14	\$50,000,000	\$364	\$145,625	\$49,854,012	\$1,134,250	\$63	\$10,747	\$1,145,060
Total Pollution Control Obligations				<u>\$137,700,000</u>	<u>\$190,339</u>	<u>\$386,181</u>	<u>\$137,123,480</u>	<u>\$4,764,682</u>	<u>\$31,020</u>	<u>\$43,546</u>	<u>\$4,839,247</u>
Purchase Contract Obligations											
Village of Hinsdale	3.000%	04/30/55	04/30/05	\$254,174			\$254,174	\$7,625			\$7,625
Total Purchase Contract Obls.				<u>\$254,174</u>			<u>\$254,174</u>	<u>\$7,625</u>			<u>\$7,625</u>
Medium Term Notes											
3N- 3037	9.170%	10/20/89	10/15/02	\$25,000,000	(\$110,252)	\$7,068	\$25,103,184	\$2,292,500	(\$71,478)	\$4,582	\$2,225,605
3N- 3038	9.170%	10/20/89	10/15/02	\$2,000,000	(\$8,820)	\$565	\$2,008,255	\$183,400	(\$5,718)	\$367	\$178,048
3N- 3039	9.170%	10/20/89	10/15/02	\$25,000,000	(\$110,252)	\$7,068	\$25,103,184	\$2,292,500	(\$71,478)	\$4,582	\$2,225,605
3N- 3040	9.170%	10/20/89	10/15/02	\$23,000,000	(\$101,432)	\$6,502	\$23,094,929	\$2,109,100	(\$65,759)	\$4,216	\$2,047,556
3N- 3041	9.170%	10/20/89	10/15/02	\$25,000,000	(\$110,252)	\$7,068	\$25,103,184	\$2,292,500	(\$71,478)	\$4,582	\$2,225,605
3N- 3032	9.200%	10/18/89	10/15/04	\$14,000,000	(\$207,888)	\$7,880	\$14,200,009	\$1,288,000	(\$58,639)	\$2,223	\$1,231,583
3N- 3033	9.200%	10/18/89	10/15/04	\$14,000,000	(\$207,888)	\$7,880	\$14,200,009	\$1,288,000	(\$58,639)	\$2,223	\$1,231,583
3N- 3034	9.200%	10/18/89	10/15/04	\$10,000,000	(\$148,491)	\$5,628	\$10,142,863	\$920,000	(\$41,885)	\$1,588	\$879,703
3N- 3035	9.200%	10/18/89	10/15/04	\$14,000,000	(\$20,789)	\$7,879	\$14,012,909	\$1,288,000	(\$5,864)	\$2,223	\$1,284,359
3N- 3036	9.200%	10/18/89	10/15/04	\$4,000,000	(\$60,105)	\$2,251	\$4,057,854	\$368,000	(\$16,954)	\$635	\$351,681
Senior Note	Variable	09/14/00	09/30/02	\$200,000,000	(\$363,608)		\$200,363,608	\$8,420,000	(\$242,184)		\$8,177,816
Senior Note	Variable	09/14/00	09/30/03	\$250,000,000	(\$900,356)		\$250,900,356	\$10,837,500	(\$359,945)		\$10,477,555
Total Medium Term Notes				<u>\$606,000,000</u>	<u>(\$2,350,131)</u>	<u>\$59,789</u>	<u>\$608,290,342</u>	<u>\$33,579,500</u>	<u>(\$1,070,021)</u>	<u>\$27,219</u>	<u>\$32,536,698</u>
Notes											
Notes	6.400%	10/15/93	10/15/05	\$235,000,000	\$3,903,484	\$229,423	\$230,867,093	\$15,040,000	\$858,814	\$50,476	\$15,949,289
Notes	7.375%	01/09/97	01/15/04	\$150,000,000	(\$95,026)	\$65,763	\$150,029,263	\$11,062,500	(\$34,004)	\$23,533	\$11,052,029
Notes	7.625%	01/09/97	01/15/07	\$150,000,000	(\$277,171)	\$94,394	\$150,182,777	\$11,437,500	(\$47,811)	\$16,283	\$11,405,972
Notes	6.950%	07/16/98	07/15/18	\$225,000,000	\$20,826,119	\$41,374	\$204,132,507	\$15,637,500	\$1,203,727	\$2,391	\$16,843,618
Total Notes				<u>\$760,000,000</u>	<u>\$24,357,405</u>	<u>\$430,955</u>	<u>\$735,211,640</u>	<u>\$53,177,500</u>	<u>\$1,980,725</u>	<u>\$92,683</u>	<u>\$55,250,908</u>
TOTAL				\$7,635,323,605	\$26,265,850	\$17,903,566	\$7,591,154,189	\$509,588,121	\$825,844	\$2,188,229	\$512,602,194

Reacquired Debt		Date Reacquired	Amortization Period Ends	Unamortized Loss or Gain on Reacquired Debt	Carrying Value	Annualized Amortization of Loss or Gain on Reacquired Debt	Annualized Debt Expense
First Mortgage Bonds							
Series 46	14.250%	11/24/87	02/15/23	\$507,678	(\$507,678)	\$23,151	\$23,151
Series 47	15.375%	11/24/87	02/15/23	\$1,473,988	(\$1,473,988)	\$67,217	\$67,217
Series 48	13.000%	03/22/88	04/15/13	\$3,107,137	(\$3,107,137)	\$256,992	\$256,992
Series 44	17.500%	05/24/88	02/15/23	\$136,525	(\$136,525)	\$6,226	\$6,226
Series 50	12.250%	11/22/88	02/15/23	\$249,745	(\$249,745)	\$11,389	\$11,389
Series 51	13.375%	11/21/88	02/15/23	\$629,098	(\$629,098)	\$28,688	\$28,688
Series 49	12.125%	12/04/89	10/15/04	\$832,303	(\$832,303)	\$433,593	\$433,593
Series 55	11.750%	12/10/91	10/15/21	\$1,671,529	(\$1,671,529)	\$190,733	\$190,733
Series 40	11.125%	06/15/92	05/15/08	\$689,406	(\$689,406)	\$96,117	\$96,117
Series 66	12.000%	03/23/93	02/15/23	\$2,579,620	(\$2,579,620)	\$117,636	\$117,636
Series 71	11.125%	05/01/93	02/15/23	\$3,065,108	(\$3,065,108)	\$139,776	\$139,776
Series 33	9.375%	05/27/93	04/15/00	\$0	\$0	\$0	\$0
Series 56	10.500%	05/27/93	04/15/23	\$3,063,575	(\$3,063,575)	\$138,649	\$138,649
Series 68	9.375%	05/27/93	04/15/00	\$0	\$0	\$0	\$0
Series 67	10.250%	06/07/93	04/15/13	\$3,731,187	(\$3,731,187)	\$308,607	\$308,607
Series 30	8.750%	08/12/93	07/01/13	\$769,511	(\$769,511)	\$132,584	\$132,584
Series 38	9.125%	08/12/93	07/01/13	\$2,128,773	(\$2,128,773)	\$366,781	\$366,781
Series 23	8.000%	08/23/93	07/15/00	\$0	\$0	\$0	\$0
Series 60	9.625%	09/01/93	07/15/23	\$2,908,245	(\$2,908,245)	\$130,135	\$130,135
Pollution Control 1985	10.375%	12/14/94	03/01/09	\$324,235	(\$324,235)	\$40,502	\$40,502
Pollution Control 1985	10.625%	12/14/94	03/01/15	\$1,633,492	(\$1,633,492)	\$133,123	\$133,123
Pollution Control 1974A	6.625%	06/27/96	12/01/06	\$71,244	(\$71,244)	\$12,562	\$12,562
Series 57	9.500%	03/11/97	01/15/07	\$1,919,606	(\$1,919,606)	\$510,931	\$510,931
				<u>\$31,492,004</u>	<u>(\$31,492,004)</u>	<u>\$3,145,391</u>	<u>\$3,145,391</u>
Sinking Fund Debentures							
Series 7	15.375%	03/16/88	04/15/00	\$0	\$0	\$0	\$0
Series 4	10.000%	04/01/92	02/01/22	\$570,673	(\$570,673)	\$27,368	\$27,368
				<u>\$570,673</u>	<u>(\$570,673)</u>	<u>\$27,368</u>	<u>\$27,368</u>

Commonwealth Edison Company

Market-Based Ratios for Staff's Samples

Electric Utility	Market/ Book ratio	Debt/ Equity	(D+P)/E
AEP	1.866	1.032	1.032
CLECO	2.094	0.819	0.835
DPL	4.123	0.585	0.593
DQE	1.952	1.194	1.208
KCPL	1.754	1.123	1.148
Nstar	1.919	1.139	1.157
Puget	1.475	1.172	1.365
Weighted Average	1.964	1.003	1.024
Simple Average	2.169	1.009	1.048

Gas Utility			
AGL	1.732	0.982	1.170
Atmos	1.435	0.976	0.976
Cascade	1.807	0.718	0.718
NUI	1.055	1.593	1.593
Northwest Gas	1.360	0.725	0.779
Peoples	1.695	0.870	0.870
Piedmont	1.892	0.476	0.476
So. Jersey Ind.	1.701	0.954	1.052
Weighted Average	1.604	0.857	0.904
Simple Average	1.585	0.912	0.954

Commonwealth Edison Company

Market-Based Ratios for ComEd's Samples

Electric Utility	Market/ Book ratio	Debt/ Equity	(D+P)/E
Cinergy	1.808	0.956	0.956
ConEd	1.622	0.723	0.750
DPL	4.123	0.585	0.593
DQE	1.952	1.194	1.208
Energy East	1.396	1.186	1.186
Idacorp	1.734	0.744	0.815
Kansas City Power & Light	1.754	1.123	1.148
Nstar	1.919	1.139	1.157
PEPco	1.296	0.987	1.022
UIL Holdings	1.415	0.951	0.951
Weighted Average	1.752	0.889	0.908
Simple Average	1.902	0.959	0.978

Gas Utility			
Atmos Energy	1.435	0.976	0.976
Cascade Natural Gas	1.807	0.718	0.718
Keyspan Corp.	1.523	1.242	1.261
New Jersey Resources	2.161	0.498	0.499
Nicor, Inc.	2.456	0.393	0.397
Northwest Natural Gas	1.360	0.725	0.779
Peoples Energy Corp.	1.695	0.870	0.870
Piedmont Natural Gas	1.892	0.476	0.476
Weighted Average	1.699	0.877	0.888
Simple Average	1.791	0.737	0.747